No. 12610

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BURNHAM ENERSEN AND NINA W. ENERSEN, RESPONDENTS

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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CITATIONS

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 71–76) are not officially reported.

JURISDICTION

These petitions for review (R. 79–81, 83–85) involve proceedings with respect to deficiencies in income tax determined by the Commissioner against Burnham Enersen (hereinafter referred to as the taxpayer) for the years 1944 and 1945 in the amounts of $237.38 and $1,150, respectively (R. 13–20), and against the taxpayer's wife, Nina W. Enersen, for the same years in the amounts of $257.38 and $983.37, respectively (R. 24, 71). The taxpayer and his wife are individuals residing in San Francisco, California, and they filed their federal income tax returns for the years

1944 and 1945 with the Collector of Internal Revenue for the First District of California. (R. 23–24, 72.) By letters dated October 26, 1948 (R. 13–20), the Commissioner of Internal Revenue notified the taxpayer and his wife, respectively, that the determination of their income tax liability for the taxable years 1944 and 1945 disclosed deficiencies in the respective amounts above stated.[1] Within 90 days thereafter, namely on November 16, 1948, the taxpayer (R. 2) and his wife (R. 4), respectively, filed with the Tax Court petitions (R. 6–20 and see fn. 1, *supra*) for a redetermination of the deficiencies determined by the Commissioner as above stated, pursuant to Section 272 of the Internal Revenue Code. On January 27, 1950, the Tax Court entered its decisions (R. 77, 78), finding no deficiencies for 1944 and 1945 as to the taxpayer and his wife, respectively. Less than three months thereafter, namely on April 21, 1950 (R. 3, 5), the Commissioner filed his petitions (R. 79–81, 83–85) for a review by this Court of the decisions of the Tax Court, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

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[1] The printed record in this Court contains only a copy of the deficiency letter addressed to the taxpayer (R. 13–20), which was attached as Exhibit A to his petition to the Tax Court (R. 6–12). The letter addressed to the wife, which was attached as Exhibit A to her petition in the Tax Court (Docket No. 20979), as well as her petition and the Commissioner's answer, and also the copies of her income tax returns for 1944 and 1945, have been omitted from the printed record by stipulation of the parties, in which it was agreed (R. 98) that, except for immaterial minor differences, they are identical to the corresponding documents in the case of the taxpayer (T. C. Docket No. 20978).

QUESTION PRESENTED

The question presented is whether an incoming partner may avail himself of Section 107 (a) of the Internal Revenue Code with respect to his share of fees received by a partnership for services performed over a period exceeding 36 months, if he has not been a member of the partnership for 36 months or more at the time of their receipt.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 107 [as amended added by Sec. 220 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and by Section 139 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE.
>
> (a) *Personal Services.*—If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.
>
> * * * * *
>
> (26 U. S. C. 1946 ed., Sec. 107.)

By Section 119 of the Revenue Act of 1943, c. 63, 58 Stat. 21, the words "AND BACK PAY" were added

to the title of Section 107 of the Code, and subsection (d)—containing provisions dealing with "back pay," not here material—was added to Section 107.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.107–1. *Personal Services.*—
>
> * * * * *
>
> It is not necessary, in order for section 107 (a) to be applicable, that the individual who includes in his gross income compensation for such personal services be the person who renders the services. For example, a partner who shares in the compensation for such personal services rendered by the partnership may be entitled to the benefits of section 107 (a), notwithstanding that he took no part in the rendering of such services.
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> * * * * *

STATEMENT

The facts in these cases, which were stipulated (R. 23–31)[2] and were found by the Tax Court to be as stipulated (R. 72), were recited by the Tax Court in its memorandum opinion as follows (R. 72–74):

Burnham Enersen, the taxpayer, and Nina W. Enersen, his wife, reside in San Francisco, California. They filed their income tax returns for the years

[2] In addition to the stipulation of facts (R. 23–31) and the exhibits attached to and submitted therewith (Joint Exhibits 1–A, 2–B, 3–C and 4–D (R. 35–44)), there were four other exhibits adduced in evidence at the hearing before the Tax Court, Exhibits E and F, the taxpayer's income tax returns for 1944 and 1945, respectively (R. 46–56, 57–68), and Exhibits G and H, the income tax returns of the taxpayer's wife for 1944 and 1945, respectively (R. 68 and see fn. 1, *supra*).

involved with the Collector for the first district of California. (R. 72.)

The taxpayer is an attorney at law. From 1930 to August 1, 1943, the taxpayer was employed continuously by a law partnership in San Francisco. He was admitted to partnership in the firm on August 1, 1943, and since that date he has been a partner in the firm. Upon his admission to partnership, he became entitled to share in fees received thereafter for services rendered by the firm over periods of several years. (R. 72.)

From the time of his first employment by the firm in 1930 or 1931 until January 1, 1940, the taxpayer was paid a monthly salary plus an annual Christmas bonus amounting to a part of a month's salary. From January 1, 1940, to August 1, 1943, the amount of taxpayer's compensation from the partnership was fixed in accordance with certain agreements which covered a calendar year, or portion thereof.[3] Under these agreements, a minimum salary was guaranteed, and above the guaranteed amount a percentage of net profits was paid. During the years 1940, 1941, 1942, and 1943, up to August first, the taxpayer received the guaranteed salary, plus a percentage of profits at the end of each year.[4] (R. 72–73.)

From and after August 1, 1943, the taxpayer, as a partner in the partnership, has at all times received

[3] Copies of these agreements were submitted with the stipulation of facts, as Joint Exhibits 1–A, 2–B, 3–C, and 4–D. (R. 35–44.)

[4] The guaranteed salary was paid monthly, while the balance, i. e., up to the amount equalling his specified percentage of profits, was paid at the end of each year. (R. 25.)

a specified percentage of the net profits of the partnership, namely, 3½ per cent from August 1, 1943, to December 30, 1945. The percentage was increased to 5.4571 per cent on December 31, 1945. (R. 73.)

The taxpayer and his wife and the law partnership have at all times followed the cash method of accounting in the keeping of accounts and the making of income tax returns; and, also, have made their respective tax returns on a calendar year basis. (R. 73.)

During 1944 and 1945, the partnership received fees from clients representing compensation for personal services which had been rendered by the firm over a period of 36 months or more, the amounts received as fees during each year on each case or matter constituting at least 80 per cent of the total compensation therefor.[5] In the case of the largest amount of those fees which the firm received in 1944, the taxpayer had performed services for clients in the matters involved during the period from January, 1940, to January, 1944; and in the case of the largest amount of those fees received in 1945, the taxpayer had performed services for the clients involved during the period from September, 1943, to December, 1945. In accordance with agreed percentages for the sharing in such fees by partners and employees who were employed on a percentage-of-profits basis, the taxpayer received $3,561.13 in 1944; and $10,791.68 in 1945, as his share of the above fees which the firm received in 1944 and 1945; i. e., of fees for personal services performed over periods of 36 months or more of which fees,

[5] The recital of this fact by the Tax Court in its opinion is not clear, but see paragraph 11 of the stipulation. (R. 26.)

80 per cent or more were received in a single taxable year. (R. 73–74.)

The taxpayer and his wife were married in 1935, and have resided together in California since their marriage, including the years 1944 and 1945. The above amounts of the shares of the taxpayer in the fees above described which were received in 1944 and 1945, constituted community property acquired subsequent to 1927. (R. 74.)

The taxpayer reported his income and computed his tax for the years 1944 and 1945 under the provisions of Section 107 of the Internal Revenue Code, as amended, as though his share of the long-term fees in question, aggregating $3,561.33 in 1944 and $10,791.68 in 1945, had been received by him ratably over the period during which the services had been rendered. He also took into consideration, in making the allocation, the fact that during the period from 1935 through 1945 he was married and his income was part of the community property of himself and his wife.[6] (R. 74.)

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[6] The taxpayer reported one half of his share of the long-term fees in question, allocated over the years of the services, in his returns for 1944 and 1945 in computing his tax thereon under Section 107 (R. 28–29, 30–31, 53, 64, 65), and his wife reported the other half in her returns (R. 30–31)—with the exception that, as to the fees received in 1945, which were for services extending from 1931 to 1945, the taxpayer reported in his own return all of the amounts allocated to the years 1931 to 1934, which preceded his marriage (1935). No question was raised as to their dividing this income, or the rest of the income from the law partnership in 1944 and 1945 (See R. 15–19, 53, 64), between them as community income (R. 74)—nor was there any controversy between the parties as to *amounts* of income or as to *computations* of the resultant tax liabilities under their respective positions, the only controversy being as to *the right* to allocate to any prior years

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The Commissioner, in his notice of deficiency, determined that the entire amount of the shares of the taxpayer in the long-term fees which were received in 1944 and 1945 was taxable in each of those years in full as ordinary income, the Commissioner holding that the taxpayer did not qualify for relief under Section 107 (a) of the Internal Revenue Code because the period of his membership in the partnership at the time of the receipt of the fees was less than 36 calendar months. (R. 16–17, 19, 74–75.)

The Tax Court, by a memorandum opinion by Judge Harron (R. 71–76), decided in favor of the taxpayer, and accordingly entered its decisions that there are no deficiencies for the years in question (R. 77, 78). The present reviews followed.

STATEMENT OF POINTS TO BE URGED

On the present reviews, the Commissioner urges and relies upon all of the points originally stated and set out by him (R. 90–91) and subsequently adopted by him in this Court (R. 95) as the points upon which he

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under Section 107 (a) of the Code any portion of the taxpayer's share of the fees for long-term services received by the partnership in 1944 and 1945 (R. 16–17, 18–19). The statement in the Tax Court's opinion that the Commissioner "has not questioned the allocation of the income in question over prior years" (R. 75) is correct only if construed to refer to the *computation* of the allocation of the income to prior years under Section 107 (a): The Commissioner in his determinations and before the Tax Court did, and does here, deny *the right* to allocate any part of the taxpayer's share of the long-term fees to any prior years *at all* on the ground that the taxpayer, having been a member of the partnership for less than 36 months when the fees in question were received by the partnership, does not qualify for Section 107 (a) treatment.

intends to rely. For present purposes, they may be briefly stated as follows: (1) The Tax Court erred in holding that the taxpayer's shares of the partnership fees in question are subject to tax under the provision of Section 107 of the Internal Revenue Code; and (2) the Tax Court erred in failing to uphold the Commissioner's determination that the income in question was taxable as ordinary income in the years received, without the benefit of Section 107 of the Internal Revenue Code, since the taxpayer's membership in the partnership was less than 36 months.

SUMMARY OF ARGUMENT

The Commissioner correctly determined that as to the fees for long-term services received by the law firm in 1944 and 1945 the taxpayer was not entitled to allocate any portion of his share to any prior taxable years at all, under Section 107 (a) of the Code, because the taxpayer had not been a partner for 36 months or more at the time of their receipt. The Tax Court was clearly in error in not sustaining the Commissioner. The decision of the Tax Court is contrary to the holding of this Court in *Lindstrom* v. *Commissioner,* 149 F. 2d 344, which is applicable and controlling here, and it should therefore be reversed.

In deciding this case, the Tax Court followed the holding of the majority of the Tax Court in *Marshall* v. *Commissioner,* 14 T. C. 90, now pending on review in the Third Circuit. The majority of the Tax Court there had held, in effect, that as long as the taxpayer was a partner when the fees were received by the partnership—regardless of whether he had been a

partner for 36 months or not—he was entitled to the benefit of Section 107 (a), and he was entitled to allocate his share of the fees over the entire period of the rendition of the services by the partnership. The Tax Court majority in the *Marshall* case, while agreeing that the Commissioner's position was correct under the statute as originally enacted and while recognizing that it had been so held in the *Lindstrom* case, had erroneously concluded that after the 1942 amendment of the statute the result contended for by the Commissioner was no longer required and treated the *Lindstrom* holding as inapplicable. That conclusion is clearly inconsistent with the purpose expressed by Congress in adopting the 1942 amendment. There is clearly no indication that, in changing the wording of the statutory provision in 1942, Congress intended anything more, in this respect, than a clarification of the provision so as to make it certain that each partner in a partnership would be eligible for Section 107 benefits regardless of whether he personally performed or participated in the services for which the long-term fee is received by the partnership.

In addition, the conclusion of the Tax Court majority in the *Marshall* case, followed in this case, is clearly contrary to the basic purpose of the statute to grant relief from the hardship falling on persons "who work for long periods of time without pay" and then receive their compensation all at one time. Before he became a partner on August 1, 1943, the taxpayer was being paid currently for his services and therefore was not one of the persons to whom Congress intended to grant relief from the hardship

resulting upon their getting paid all at one time for long-term services.

ARGUMENT

An incoming partner may not, for the purpose of qualifying for the privilege of spreading income back over years prior to the year of its receipt under Section 107 (a) of the Internal Revenue Code, tack on to his period of membership in the partnership the period of services rendered by the partnership prior to his becoming a member

This case presents a pure question of law, arising under Section 107 (a) of the Internal Revenue Code, *supra.* Section 107 (a), as amended by Section 139 of the Revenue Act of 1942 and as applicable to the taxable years here involved, provides, in substance, that if at least 80 per cent of the total compensation for personal services covering a period of 36 months or more is received by an individual or a partnership in one taxable year, the tax attributable to any part of that compensation which is included in the income of any individual shall not be greater than the aggregate of the taxes which would have been attributable to that part if it had been included in income ratably over that part of the period of the services which precedes the date of the receipt of the compensation.

In this case, there was no controversy with respect to the requirements of Section 107 (a) relative to the percentage of the compensation or to the length of the services themselves: the stipulated facts demonstrate (R. 26) that, as to all of the fees for long-term services in question received by the partnership, the amount of compensation received constituted in each case at least 80 per cent of the total compensa-

tion for the particular services, and that each of the respective services was rendered over a period exceeding 36 months. The taxpayer did not become a partner until August 1, 1943 (R. 25), which is less than 36 months before the receipt of the fees for the long-term services in question by the partnership in 1944 and 1945, and the only issue in the case, as the Tax Court put it (R. 71), was as to whether the taxpayer was entitled to apply Section 107 (a) so as to include in the time of the rendition of the services the period of services prior to his admission to the partnership—or, stated differently, whether an incoming partner may tack on to his period of membership in the partnership the period during which services were rendered by the partnership prior to his admission to the partnership.

The taxpayer, in his returns and before the Tax Court, claimed the right to compute his tax liability for the taxable years here involved under Section 107 (a) of the Code by allocating his share of the fees for long-term services received during 1944 and 1945, by the partnership of which he was then a member, over the entire period of the rendition of the respective services in question, going back in one instance as early as 1931, in spite of the fact that he did not become a member of the partnership until August 1, 1943. (R. 25, 26, 28, 29, 74.) The position taken by the Commissioner, in his determination of the deficiencies and before the Tax Court, was that with respect to the fees for long-term services received by the partnership in 1944 and 1945 the taxpayer was not entitled to allocate any portion of his

share to any prior taxable year at all, because he had not been a partner for 36 months or more at the time of their receipt. (R. 15–19, 71, 74–75.)

The Tax Court, in deciding this case in favor of the taxpayer, followed its decision in *Marshall* v. *Commissioner,* 14 T. C. 90, now pending before the Court of Appeals for the Third Circuit on petitions for review by the Commissioner. The issue in the *Marshall* case was whether, as to fees received by the partnership in 1942 and 1943 when the taxpayer there had been a member of the partnership less than 36 months, the taxpayer there could allocate any part of his share of those fees to any prior year under Section 107 (a), and, further, as to fees received by the partnership in 1945 after he had been a partner for more than 36 months, whether he could allocate any part of his share to years prior to his admission to the partnership.

In deciding the *Marshall* case in favor of the taxpayer, the Tax Court, in the majority opinion (14 T. C. 91–95), held in effect that as long as the taxpayer was a partner at the time the fees were received by the firm, he was entitled to the benefit of Section 107 (a), regardless of the fact that at the time of the receipt of some of the fees he had been a partner for less than 36 months, and further, that he was entitled to allocate his share of the fees over the entire period of the rendition of the services since, in the view of the Tax Court majority, it is the status of the recipient of the income in the year of receipt which governs the application of Section 107 in its present form, after the 1942 amendment. The conclusion of

the Tax Court majority in the *Marshall* case, followed in this case, is erroneous, we submit, and it is clearly contrary to the decision of this Court in *Lindstrom* v. *Commissioner,* 149 F. 2d 344.

In the *Lindstrom* case, a partner who, at the time of the receipt by a partnership of a fee for long-term services, had been a member of the partnership for 45 months, or for less than the minimum period of services prescribed by Section 107 before the 1942 amendment,[7] claimed that he was entitled to the benefit of Section 107 solely because "he received the fee in question 'as a member of a partnership' " (p. 346), or, in effect, because he was a member of the partnership when the fee was received—in substance, the same claim as that made by the taxpayer in this case and in the *Marshall* case. This Court rejected that claim, holding in effect that a partner, to meet the period of service requirement in order to qualify for the benefit of Section 107, could not tack on to the period during which he rendered services that period during

[7] Prior to that amendment, Section 107, as originally added to the Code by Section 220 of the Revenue Act of 1939, c. 247, 53 Stat. 862, provided as follows:

> In the case of compensation (a) received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership, and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services, and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period.

which his partner had rendered services as an individual prior to the formation of the partnership. The Tax Court, in the majority opinion in the *Marshall* case, recognized (p. 92) that the Commissioner's position concededly "was the only tenable one" under Section 107 prior to the 1942 amendment, and further recognized that it had been in fact so held in the *Lindstrom* case, but it concluded that after the 1942 amendment the results contended for by the Commissioner were no longer "required" (p. 94), and hence it treated the holding of the *Lindstrom* case as inapplicable.

As originally added to the Code, Section 107 had provided that as to compensation "received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership," if the specified period of service and percentage of payment are satisfied, then "the tax attributable to such compensation" is to be computed on the Section 107 formula—i. e., the tax shall not be greater than the aggregate of taxes on such compensation would have been had it been received in equal portions during each of the years of the rendition of the services. After the 1942 amendment, the language was changed so as to read that if "compensation for personal services * * * is received or accrued * * * by an individual or a partnership," in the required percentage and for services covering the specified period, then "the tax attributable to any part thereof which is included in the gross income of any individual" is to be computed on the Section 107 formula. The majority of the Tax Court in the *Marshall* case

stated that the amendment reversed the emphasis "from the person who renders the services to the person who is required to report the income" (p. 93), and went on to conclude (pp. 93–95) that the elimination of the requirement of actual participation in the services had the effect of giving the taxpayer, upon the facts of that case, the right to use the Section 107 computation as to all of the long-term fees and to allocate his share of the fees over the entire period of the services.

It is submitted that the holding of the *Lindstrom* case, *supra,* is applicable even after the 1942 amendment of Section 107 and is controlling here. See G. C. M. 25795, 1948–2 Cum. Bull. 61. In taking the opposite view, the majority of the Tax Court in the *Marshall* case pointed (p. 92) to the observation made by this Court, in affirming the *Lindstrom* case, to the effect that the 1942 amendment did not apply to that (the *Lindstrom*) case. We do not believe, however, that that observation by this Court signifies what the majority of the Tax Court in the *Marshall* case seems to suggest, namely, that this Court would have reached a different conclusion, if the 1942 amendment had been applicable, on the particular point before it as to whether the taxpayer there was entitled to Section 107 treatment simply because he received the portion of the fees in question as a member of a partnership even though his period of service as a partner was not sufficient to meet the five year requirement originally specified by Section 107. In view of the fact that the 1942 amendment reduced the minimum period of service to 36 months, it seems more reasonable to

regard the observation made by this Court as one aimed at the change in the minimum period (instead of at the changed wording of the section) because if the 1942 amendment had been applicable there would have been no controversy, since the taxpayer there would have qualified under Section 107 because of his 45 month period as a partner.

Although the taxpayer's claim for the benefits of Section 107 (a) in this case, and in the *Marshall* case, may be "within a permissible interpretation" (14 T. C. at p. 93) of the language of the statute after the 1942 amendment, we submit that it is not within what Congress actually intended—it is not within the intent expressed by Congress in making the particular change in the wording of Section 107 above referred to.

In the Revenue Bill of 1942 (H. R. No. 7378, 77th Cong., 2d Sess.), the House Ways and Means Committee recommended changes in Section 107 with respect to the taxing of compensation for long-term services so as to reduce the period of service from five years to 36 months and the percentage of payment from 95 to 80, and also added a new provision to cover authors, composers and inventors. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 90–91 (1942–2 Cum. Bull. 372, 441). In the bill as passed by the House, the pre-existing provision of Section 107 became Section 107 (a), and the same wording was retained, except for the change with respect to the length of period and percentage of payment. See 88 Cong. Record, Part 6, p. 7810. The Senate Finance Committee revised the wording of Section 107 (a) so as to read as

finally enacted into law (*supra*), and in its report made the following explanation (S. Rep. No. 1631, 77th Cong., 2d Sess., p. 109 (1942–2 Cum. Bull. 504, 586)):

> In order for section 107 (a) to be applicable, it is not necessary that the individual who includes in his gross income compensation for such personal services be the person who renders such services. For example, a partner who shares in compensation for such personal services rendered by the partnership may be entitled to the benefits of section 107 (a), notwithstanding that he took no part in the rendering of such services. Likewise, in community property States, the spouse of a person who renders such personal services may be entitled to the benefits of section 107 (a).

Thus, in so far as stated by Congress, its purpose in the change of the language seems to have been limited to a desire to enable a partner to obtain the benefits of Section 107 as to compensaton received by him for "services rendered by the partnership * * * notwithstanding that he took no part in the rendering of such services," and also to enable spouses of persons performing long-term services to take the benefits of Section 107 in community property states. As originally enacted in 1939, the wording of Section 107 was such that it could have been construed so as to deny relief to a partner who did not personally participate in rendering the services with respect to which the fee was received by the partnership. There is no indication that, in changing the language of Section 107, Congress (aside from enabling spouses

in community property states to take the benefit of Section 107) had in mind anything other than clarifying the statutory provision so as to avoid the result which would have been possible under the original wording and so as to make it certain that each individual partner in a partnership would be eligible for the benefits of Section 107 regardless of whether he personally participated in the work which brought in the long-term fees. See H. Rep. No. 2333, *supra;* S. Rep. No. 1631, *supra,* pp. 48–49, 108–110 (1942–2 Cum. Bull. 504, 544, 585–587); H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 42 (1942–2 Cum. Bull. 701, 706–707). The elimination of the requirement of actual participation in the services, to which the majority opinion of the Tax Court in the *Marshall* case pointed (p. 94), was, in so far as the expressed intent of Congress goes, intended only to eliminate the requirement, which Section 107 as originally enacted might have been regarded as containing, that any member of a partnership claiming the benefits of Section 107 must establish that he personally performed or participated in the services on the particular matter with respect to which the long-term fee is received. In other words, at least in so far as expressed, the Congressional will was to clarify the provision so as to grant the Section 107 treatment to a partner of the firm which performed services over the required period, and received the required percentage of compensation in a single taxable year, regardless of whether the particular partner personally participated in the particular services.

In addition to being out of harmony with the purpose expressed by Congress in making the 1942 amendment to Section 107, the conclusion of the majority of the Tax Court in the *Marshall* case is contrary to the basic purpose of Section 107. When Section 107 was originally added to the Code by the Revenue Act of 1939, its purpose was stated to be to grant relief from the "hardship" falling upon persons "who work for long periods of time without pay" and then receive their compensation in a lump sum all in one year. S. Rep. No. 648, 76th Cong., 1st Sess., p. 7 (1939–2 Cum. Bull. 524, 528–529). There is no indication whatsoever that Congress, in amending the law in 1942, intended in any way to depart from that basic purpose.

The relief which Congress granted from the hardship falling on those persons "who work for long periods of time without pay" and then are paid all at one time, was to allow them to pay no more tax in the year of receipt of their long-term pay than they would have paid if they had received their compensation ratably over the period of the services. In other words, Congress wanted to place them in the same position, for income tax purposes, that they would have been in if they had received their compensation currently over the years and had paid income taxes thereon each year. Looking at the basic purpose of Section 107, it is clear that the taxpayer, in so far as he shared in fees collected by the partnership during the taxable years relative to services performed prior to the time he became a partner, is not one of the persons to whom Congress

intended to grant relief. Before he became a partner on August 1, 1943, the taxpayer was not a person working "for long periods of time without pay" who later was paid all at one time. For all of the years prior to August 1, 1943, the taxpayer was being paid currently for his personal services. What he received during the taxable years, 1944 and 1945, as his share of the income of the partnership constituted his compensation for personal services during each of *those* years, respectively. In so far as what he received also included a portion of fees collected by the partnership for services which the partnership had performed prior to the time the taxpayer became a partner, that to him was income in the nature of "windfall" income: that was not, to the taxpayer, income received all at one time for services performed "for long periods of time without pay," as to which Congress intended to grant relief from the resulting hardship tax-wise.

Clearly, the conclusion of the Tax Court majority in the *Marshall* case, adopted by the Tax Court in this case, is contrary to the basic purpose of the statute and is erroneous. In this case, the Tax Court in its memorandum opinion stated (R. 75–76) that this case on its facts is even stronger in favor of the taxpayer than the *Marshall* case, because in this case "the taxpayer rendered services over a period of several years" for which the long term fees were received by the partnership in 1944 and 1945,[8] and

[8] The taxpayer's participation, prior to his admission to the partnership, in the long term services for which the fees in question were received, was limited, as the stipulation shows (par. 11,

also because the taxpayer here was associated with the firm throughout the entire period over which he seeks to allocate the income in question. These factual differences do not make the taxpayer's position in this case less contrary to the basic purpose of Section 107 than that of the taxpayer in the *Marshall* case: it is still true in this case, as in the *Marshall* case, that until the taxpayer was admitted to the partnership he was being compensated currently for his services and therefore was not a person who worked "for long periods of time without pay" and then received his compensation all at one time, the hardship of which was intended to be relieved by Section 107.

Nor is a different result required in this case by reason of the fact that for part of the time before being admitted to partnership the taxpayer was an employee paid on a profit sharing basis, receiving a guaranteed minimum salary and above that a percentage of net profits, between January 1, 1940, and August 1, 1943. (R. 24–25, 35–44, 72–73.) Nor can that fact entitle the taxpayer to tack his profit sharing period on to his partnership period, so as to give him the qualifying minimum of 36 months or more and thus entitle him to the benefits of Section 107 to the extent of an allocation over that combined period (for a partial allocation back, as the Commissioner permitted in the *Marshall* case with respect to

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R. 26), to his being "one of the attorneys performing the services" from January 1940 to January 1944 in only one case or legal matter, identified in the stipulation only as one on which "one of the largest" of the long term fees was received in 1944.

the fees there received in the year 1945). Even during the profit sharing period, as before, what the taxpayer received was his full compensation for all his personal services during each year. Although, in addition to his guaranteed salary, he had the right to share in profits up to his specified percentage during the profit sharing period, his right to share therein was limited to fees currently collected by the firm during that period. (See stip. par. 12, R. 26–27.) He was not in any sense a partner (see California Corporation Code, Section 15007 (4) (b) (formerly Civil Code Section 2401); and see also *O. Krenz C. & B. Wks., Inc.* v. *England,* 109 Cal. App. 747, 293 Pac. 689; *Sievert* v. *Simonds,* 89 Cal. App. 2d 34, 200 P. 2d 95; *Lyden* v. *Spohn-Patrick Co.,* 155 Cal. 177, 100 Pac. 236; *Coward* v. *Clanton,* 122 Cal. 451, 55 Pac. 147; *Black* v. *Brundige,* 125 Cal. App. 641, 13 Pac. 999) and acquired no proprietary right to fees accruing to the partnership but not collected. What he received as a profit sharing employee was expressly stated in the agreements (Joint Exhibits 1–A through 4–D, R. 35–44) as being paid to the participants "by way of compensation only and not as parties to a joint business venture", and the agreements further provided that "the participating privilege does not constitute participants partners" (R. 36, 38–39, 40, 41, 43).

It may be pointed out in passing that we do not believe any significance ought to be accorded, as the Tax Court majority in the *Marshall* case seems to have done (p. 93), to the fact that the arrangement, whereby the partners permitted the taxpayer there to share

in fees received by the partnership after his admission to the partnership for work performed prior thereto, may well have been "an obviously arm's length business transaction" and may well have had "a business purpose." That the other partners were willing to give the taxpayer that benefit, is immaterial: what the taxpayer in that case received during each of the years 1942, 1943 and 1945 was as to him compensation for his services during each of those years, respectively, as pointed out in the dissenting opinion (pp. 96–97), even though measured in part by an amount equal to a percentage of fees for legal services performed by the partnership prior to the taxpayer's admission thereto. The same applies to what the taxpayer in this case received during the taxable years 1944 and 1945: it was compensation for his services during *those* years. Before becoming a partner, while working as an employee of the firm, the taxpayer had been paid for his services currently, and therefore was not working "for long periods of time without pay" so as to qualify for the relief which Congress intended to grant by Section 107.

While the purpose of Section 107 (a), to alleviate the hardships falling on those who receive all at one time compensation for services of long duration, should not be defeated by too strict an interpretation, nevertheless the statute should not be extended beyond the expressed will of Congress. This is particularly true in the case of a provision constituting an exception to the fundamental principle governing the taxation of income upon the basis of annual periods and annual accountings (*Burnet* v. *Sanford & Brooks Co.*,

282 U. S. 359; *Heiner* v. *Mellon,* 304 U. S. 271; *Security Mills Co.* v. *Commissioner,* 321 U. S. 281), such as Section 107 (a). *Lindstrom* v. *Commissioner,* 149 F. 2d 344, 346.

To be entitled to the special tax treatment accorded by Section 107, a taxpayer should be required to bring himself within the letter and the spirit of the Congressional grant. *Lindstrom* v. *Commissioner, supra,* p. 346. *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46. In the *Lindstrom* case this Court, viewing Section 107 as akin to a special exemption provision, observed that such provisions are "to be strictly construed" (p. 346). See *Sovick* v. *Shaughnessy,* 92 F. Supp. 202, 205 (N. D. N. Y.); cf. *Slough* v. *Commissioner,* 147 F. 2d 836 (C. A. 6th). In speaking of Section 107, the Court of Appeals in *Smart* v. *Commissioner,* 152 F. 2d 333, 335 (C. A. 2d), certiorari denied, 327 U. S. 804, stated that "the section is an exemption and as such must submit to close scrutiny; and—what is more important—Congress has been sparing in the relief given." After noting the provisions of Section 107 in its original form and the changes made by the 1942 amendment, the Court of Appeals further observed that it was not permitted "any assumption that it [Section 107] is infused with a broad purpose, which we should ramify as the occasion may demand." (P. 335.)

While the taxpayer's position may be "within a permissible interpretation" (14 T. C. at p. 93) of the language of the statute as amended in 1942, it is not within the intent expressed by Congress, as we have shown, and to sustain it would lead to absurd and

unreasonable consequences. Under the holding of the majority of the Tax Court in the *Marshall* case, followed in this case, if an individual be a member of a partnership—even though for only one day—at the time it receives a fee for services rendered over a period of say 20 years, he would be entitled to the benefit of Section 107 (a) with respect to his distributable share, and would be allowed to allocate his share over the 20-year period of the services. If such an unreasonable result, so clearly at variance with the basic purpose of Section 107, be permitted by the literal words of the statute, then the purpose—rather than the literal words—should be followed. *United States* v. *Amer. Trucking Ass'ns,* 310 U. S. 534, 543.

Another aspect of this question might be commented upon briefly before closing. In the majority opinion of the Tax Court in the *Marshall* case, it is stated that the Commissioner "apparently accepts the further proposition that the accession of petitioner [taxpayer] to the partnership did not bring about a dissolution of the old firm nor create a new one * * * so that it can not successfully be contended that the services were not rendered by the partnership of which petitioner became a member." (14 T. C. at p. 93.) That statement demonstrates that the conclusion of the majority of the Tax Court in the *Marshall* case implicitly rests on the assumption that the long-term services there in question, covering the years 1932 to 1945, were performed by a single separate entity. That assumption is erroneous: the law firm, whether viewed as the same continuing partnership or as a series of successive partnerships coming into exist-

ence on each change in membership, was not an entity separate and apart from its members. See Internal Revenue Code, Sections 181 to 190; *Randolph Products Co.* v. *Manning,* 176 F. 2d 190 (C. A. 3d); *Commissioner* v. *Whitney,* 169 F. 2d 562 (C. A. 2d), certiorari denied, 335 U. S. 892; *Helvering* v. *Smith,* 90 F. 2d 590 (C. A. 2d); G. C. M. 25795, 1948–2 Cum. Bull. 61. This fundamental principle, that for tax purposes a partnership does not exist as an entity separate and apart from the partners, was properly recognized in the dissenting opinion of Judge Hill in the *Marshall* case. (Pp. 95–96.) As correctly pointed out in that dissenting opinion (p. 96), the long-term services in that case were rendered not by the taxpayer individually but in part (before January 1, 1941) by a group of individuals or a partnership of which the taxpayer was not a member, and in part (after January 1, 1941) by a group of individuals or a partnership of which the taxpayer was a member. And that dissenting opinion, we submit, expresses (p. 96) the correct conclusion in that case, namely, that the partnership services rendered prior to January 1, 1941, are not attributable to the taxpayer or available to him for the application of Section 107 (a) because he was not a member of the partnership which rendered those services. And the same is true in this case: the partnership services rendered prior to August 1, 1943, are not attributable to this taxpayer or available to him for the application of Section 107 (a) because he was not a member of the partnership which rendered them. The partnership services rendered prior to August 1, 1943, can no more be

availed of by the taxpayer for the application of Section 107 (a) than could services rendered before that date by some other individual lawyer who on that date had formed a partnership with the taxpayer. Cf. *Lindstrom* v. *Commissioner, supra.*

CONCLUSION

For the foregoing reasons, it is submitted that the decisions of the Tax Court in these cases should be reversed, and the determinations of the Commissioner reinstated.

Respectfully submitted,

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